# PRESENTATION AT SEMINAR ON ENVIRONMENTAL ISSUES (10/90)

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My talk today will focus on one key environmental area, namely the problem of pollution from hazardous waste sites, and the means that Congress has chosen to deal with the problem through the passage in 1980 of the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), popularly known as Superfund.

The main points that I would like to make are:

1. All experts agree that the scope of the hazardous waste problem in this country is enormous.

2. Under existing law, the potential cost of cleaning up these sites and compensating those who may allege bodily injury and property damage is well beyond the financial capacity of the private business sector.

3. In its ten years of existence the Superfund liability system has proven to be an utter failure, having produced very little in the way of cleanup, but a great deal in the way of complex and costly litigation.

4. Alternatives to Superfund are desperately needed. Some have already been suggested, including one by my company, The Hartford Insurance Group.

5. Finally, the actuarial profession, which to the best of my knowledge has mostly been in the background of this debate, can play a vital role in helping to shape workable alternatives to the present liability system.

Let me start by briefly reviewing the origins of Superfund. In the 1970's Congress became increasingly aware of the threat of soil and groundwater pollution from a great number of hazardous waste sites that gradually had been built up over the years. The highly publicized pollution at the Love Canal Landfill in New York State, and the effect on residents in that area, was the main catalyst that drove Congress to enact Superfund.

Superfund was intended to be a crash program to clean up - through a massive infusion of money - the most serious abandoned hazardous waste sites in the country. By focussing on the old abandoned sites, Superfund was a counterpart to RCRA, the Resource Conservation and Recovery Act, which Congress had enacted four years earlier. While Superfund addressed the cleanup needs of abandoned sites, RCRA established standards for the management of active hazardous waste facilities. In other words, the purpose of RCRA is to make sure these existing active facilities do not eventually become Superfund sites. It is important to keep this distinction in mind because to date most of the hazardous waste pollution problem in this country relates to the old abandoned sites addressed by the CERCLA Act in 1980 rather than the newer facilities regulated under the RCRA Act of 1976.

Superfund looks to two sources of money to perform its functions:

1. A tax, partly from general revenues and partly from various corporate sources. Under the original CERCLA enactment of 1980 this tax produced a fund - called the "Superfund" - of $1.6 billion for the first five years of the program. It was increased to $8.5 billion when the program was reauthorized for another five years in 1986 under an enactment called the Superfund Amendments and Reauthorization Act (SARA). The funding of Superfund under the SARA reauthorization will run out in October of 1991, at which time Congress must again act if the program is to continue.

2. As large as the Superfund seems, both from its name and the amount thus far authorized - $10.1 billion, these government financed cleanups are intended to cover only a small portion of the cleanups contemplated under the legislation. The second source of funding, and by far the most significant, is intended to come from the strict, joint and several liability system established under the Act, and applicable retroactively to events that took place years before enactment of CERCLA in 1980.

Cleanups are to be financed with the Superfund tax money only in emergency situations (subject to reimbursement from the responsible parties) and where no solvent responsible parties can be found. The real success of Superfund hinges upon the ability of the Government to win lawsuits against various categories of private parties who under the law

are considered responsible for the pollution. In the vernacular of Superfund they are called PRPs, standing for "potentially responsible parties." The range of PRPs is very large, including not only large industrial corporations, but also small business, lending institutions and municipalities. Unlike a normal public works approach, Superfund is almost exclusively a litigation driven system.

The liability system established under the statute is incredibly severe and intentionally so, as this was thought to facilitate cleanups. Any owner or operator of a site, any transporter of hazardous materials to a site, any generator of hazardous material that ends up at a site can be held liable for the entire cost of cleanup, regardless of how little or how much that person contributes to the site, if there is a release, or threatened release, of a hazardous substance from the site. Thus, the liability system is:

1. Joint and several - one "deep pocket" may have to foot the entire bill, even though there may be other contributors to the pollution.

2. Absolute - i.e. no causal connection need be established between the substance attributable to the PRP and the substance that actually leaked.

3. Strict - no showing of fault or negligence is required.

4. Retroactive - in many, if not most instances, the liability applies to things people did long before the law was created. In this sense, it is analogous to an ex post facto law, which in a criminal context is specifically prohibited by the United States Constitution.

The theory behind so Draconian a liability system was that it would generate a huge inflow of dollars from PRPS in a short period of time. This was felt to be necessary to respond to such a critical public health need, and to "make the polluter pay". It was to have all the advantages of a public works program, without the political disadvantage of financing out of general revenues.

Turning for a moment from the liability system to the dollar costs of the system, the projected ultimate cost of cleanup has been estimated by various private and governmental sources to run anywhere from $100 to $700 billion, and perhaps even higher. If there is any one prevailing characteristic of these cost estimates, it is uncertainty. There have been wide ranges in the estimates of the number of sites needing attention, the average cost of cleanup and the time required to do the job. There is even less predictability to the likely cost of private bodily injury and property damage suits that may be filed in the wake of the cleanups. The only point of common agreement is that the final bill will be very large.

Given these two factors, (1) the enormous scope and unpredictability of the cleanup costs, and (2) the arbitrary system for assigning responsibility, it was naive indeed for Congress to expect the PRPs to roll over like tin soldiers and accept their medicine. It was a survival issue, and one punctuated by important notions of fairness. Under these circumstances resistance was inevitable, and that is what has occurred. Instead of a crash program to achieve cleanup in a few years, let's look at what has actually happened:

1. EPA data, as reported in a study by the Institute for Civil Justice, shows that in the first 8 years of the Superfund program only 34 of the then 1,175 on the National Priorities List (NPL) had been fully cleaned up. The NPL is a list of the sites most critically in need of attention. It is a list that is continually growing, and is expected by EPA to exceed 2,000 by the year 2000. Estimates of the average cost of cleaning up an NPL site run as high as $30 million.

2. In a recent Management Review of its own performance, EPA admits "Currently, sites are added to the NPL at a rate that exceeds the rate of cleanup."

3. Studies by both the Institute for Civil Justice and the Congressional Office of Technology Assessment have shown that the Government's spending of Superfund money is very inefficient. Much less than half of the funds appropriated have been spent on actual cleanup.

This kind of poor performance, slow pace of cleanup and inefficient use of available funds, is bound to be the natural outgrowth of a system that depends on establishment of site-by-site liability as its main source of funding.

The Superfund litigation explosion, of course, is not confined to government actions against PRPs. Faced with enormous, unexpected and therefore unbudgeted expenses, it was natural for the PRPs to search desperately for someone else to pay the bill. And so they looked to their insurers. It mattered not that the policy didn't actually cover the risk, as it clearly didn't. In desperation one doesn't worry about such niceties.

And so a secondary level of litigation was spawned, cases brought by PRPs against those who issued them comprehensive general liability policies at the time of the alleged pollution. The insurance industry steadfastly denies that CGL polices were ever intended to cover gradual seepage of pollutants, and therefore, didn't take these coverage claims seriously at first. The industry was shocked, however, by an early New Jersey decision, the Jackson Township case. In that case a New Jersey state intermediate court found coverage for gradual seepage of pollutants in spite of the fact that the policy specifically limited coverage to sudden and accidental pollution events. An even more brazen disregard for policy language occurred in a later New Jersey decision, subsequently

reversed on appeal, in which the court acknowledged that the insurer unambiguously intended no coverage, but nevertheless found coverage because of the court's determination of a societal need to broaden the sources of funding as much as possible to cover these huge costs.

Some of these coverage cases are incredibly complex declaratory judgment actions where an insured will attempt to get a judicial resolution in one legal action of its rights against all of its CGL carriers over the past 30 or 40 years at all sites in the country. For example, Westinghouse brought an action against 140 insurers to determine coverage at 74 sites scattered throughout the country. Much of the early legal jousting in this case involved the issue of what courts had jurisdiction to determine coverage at what sites. I think you can easily visualize that this kind of lawyer's paradise isn't what Congress had in mind when it thought it had created a crash program for site cleanup.

I will not attempt to give you any scorecard on the coverage cases to date, except to point out that there now have been a substantial number of decisions in state and federal courts that go both ways. In several instances there are conflicting decisions within a single state. It is clear that neither side is going to win the coverage litigation battle. Perpetuating this senseless war will just be an enormous waste of resources that benefits no one except the trial bar.

The volume of coverage litigation directed against insurers, together with the fact that some cases have gone against us, gives the insurance industry a vital stake in Superfund. It doesn't take much actuarial expertise to realize that the approximately $125 billion of surplus in our entire industry cannot begin to pay for total cleanup costs of our country, to say nothing of the private BI and PD actions. Of course, much less than that $125 billion is available, because only the principal writers of general liability have the exposure. It is in our self-interest, as well as that of society, to find a better way to address this problem.

At least two insurers have proposed specific alternatives to the present system. In 1988 The Hartford proposed the creation of a Comprehensive Environmental Response Authority (CERA) to fund both cleanup and private compensation arising out of pollution events. This was followed a year later by the American International Group's proposal of a National Environmental Trust Fund (NETF) to fund cleanups from commercial premium taxes.

Let me describe The Hartford's proposal first. Knowing that an essential underpinning of Superfund is the strong feeling by Congress and the environmental community that the "polluter must pay," total abolition of the joint and several liability system is probably not politically feasible. Under our proposal, the joint and several system remains intact, but each PRP and insurer has the option of buying out of its retroactive liabilities on an aggregate basis by payment of annual

assessments to CERA, which would be a federal agency, probably a Division of EPA. The assessment base would have to be distributed in such a way that it reflects as practically as possible, relative exposures to liability under the present system. The incentive to join CERA would be the substantial relief from present transaction costs as well as the replacement of certainty for open-ended and uncertain future liabilities. The CERA assessments would have to be capped, with Government being willing to pick up any excess needs. The payment mode would be similar to taxation, except that it only comes about through a voluntary agreement by the payer with the federal government. Those who wished to continue with the present site-by-site litigation approach would be free to do so, but we feel most PRPs and insurers would be attracted to the ability under CERA participation to budget for these future assessments in a predictable way.

The purpose of CERA is to take the cleanup problem out of the litigation arena and put it back into the engineering arena, where it belongs. Funds for cleanup would be produced more expeditiously, the pace of cleanup would thus be greatly improved, protracted lawsuits would end and business could once again budget for expenses that now would be predictable. The "polluter pay" principle would not be violated because CERA assessments would be weighted according to information available as to past pollution activity, and because those who wilfully violated the law would be denied access to the program altogether. Since the program applies only to retroactive liability arising out of past pollution, it

in no way would interfere with the incentives for good behavior that some feel are built into the Superfund liability system. In short, we feel a program of this type would serve all interests in the environmental area, including that of society as a whole.

In our public release of the CERA proposal, our then CEO, DeRoy C. Thomas, emphasized that CERA was only a beginning in the search for Superfund alternatives and that we would welcome other ideas intended to accomplish the same result. About a year later AIG announced a similar proposal. It calls for funding retroactive cleanup costs through a tax on commercial insurance premiums. This is in a sense a "rough justice" application of the CERA need for an assessment base. It isn't scientific, but it is simple to apply. It isn't scientific because it would only be happenstance if the relative distribution of commercial premiums correlated with relative exposure under the present liability system.

There are other questions raised by the AIG proposal:

1. Since it applies to cleanup only, how does one deal with the enormous potential third party liabilities from past pollution.

2. What would be done about self-insurers? AIG says there would be a substitute system, but doesn't explain what it is.

3. Is the "rough justice" politically acceptable, especially since it apparently does not acknowledge that insurers have lost some of the coverage cases.

4. Will it be viewed as consistent with the continuing Congressional demand that "the polluter must pay"?

In spite of the apparent failure of Superfund, Congress, EPA, the environmental community and others have been very reluctant to admit that it is in need of major change. There are a number of possible reasons for this. One is the tendency to want to wait and see if a new EPA director or a new Presidential administration would produce change. After two administrations and 4 or 5 directors since the program began, one wonders how long this will continue to be a reason for delay.

Another reason is a lack of exact data as to the economic impact on the private sector. There have been general proclamations as to the grave threat of the Superfund liability system to PRPs and insurers, but no firm numbers. Congress is more likely to be spurred to action if it has the means to compare the likely financial impact of the present system with any new proposal it is being asked to consider.

There have been several attempts to obtain such data. The General Accounting Office (GAO) tried to assess the impact on insurers in connection with an insurability study a few years ago. It has recently

sought the same information in connection with a current Congressional hearing. ICJ has interviewed both insurers and PRPs for this type of information, as has another privately funded organization called the Coalition on Superfund.

In each such instance the available data in and of itself has not been considered adequate. In the case of our industry, for example, it is not difficult to understand why this is true. Although most of the pollution events have already taken place and much of the litigation has commenced, very few of the cases have reached the stage of maturity where reliable estimates of ultimate losses are possible. Any documentary evidence that is produced is likely to seriously understate ultimate costs, but we don't know by how much. Although we are not as familiar with corresponding accounting practices of the PRPs, we suspect they are having the same difficulties. There have been published reports that the SEC and accounting firms are worried about a possible understatement of these liabilities by PRPs.

Although the data may be limited in terms of actual expenditures, it may be sufficient to begin to make some statistical projections, or a range of such estimates, as to ultimate costs. This very thing was suggested by CAS member Amy Bouska in a recent issue of the Tillinghast publication EMPHASIS. Certainly the tools are out there with which to work. A great deal has been expended in some of the preliminary stages of a cleanup, such as site evaluations and legal transaction costs. Government sources have published a number of estimates as to the number of sites that will

need attention, and the average cost of cleaning up those sites. Finally, there are the court decisions. The body of case law on coverage decisions is growing rapidly. Admittedly, they form no consistent pattern, but actuaries are used to dealing with crazy quilts. We may be reaching the point where some reasonable estimates can be made of the ultimate distribution of cleanup costs between the PRP and insurer sectors. This information would be an essential ingredient of a voluntary buy-out program such as CERA.

In short, I think actuaries can play a significant role in solving the problems of the system. There has been widespread frustration over the information gap as respects Superfund data. I think actuaries can fill that gap. Actuaries cannot create data out of thin air. No one expects that. The challenge is a difficult one, but like Amy Bouska, I feel there is enough raw material out there to permit the kind of projections that will lead to better understanding of the problem we are dealing with and point the way to solutions. Perhaps projects of this type have already begun. I'm encouraged to see that one of the topics of this seminar is "Procedures to Estimate the Cost of Environmental Hazards." I hope this is not limited to estimating prospective exposures, but also includes estimates of the much greater retroactive pollution costs. Maybe a new twist can be put on the old joke about actuaries and chaos. In this instance perhaps actuaries can begin to produce some order out of the seeming chaos.

As a final comment, I would like to make note of the importance of coalition building in any Superfund reform effort. Naturally, Congress will be more receptive to a program if it serves the interests of all involved parties. We at The Hartford like CERA for this very reason. It produces a better system from the points of view of the Federal government, environmentalists, the industrial community, local governments, insurers and the general public.

In this connection, let me read to you a comment on Superfund that appeared in a recent magazine publication:

> "SUPERFUND. Perhaps the worst 'pro-environment' idea ever promulgated. This highly publicized program to clean up toxic waste dumps and sue the perpetuators for damages has used a huge $2 billion chunk of EPA money for tiny gain. Since Superfund was enacted in 1980, roughly half of its outlays have gone to legal fees, while only 8% of the culpable polluters have actually made restitution. And of the 1,200 Superfund sites, less than 5% have been given a clean bill of health."

You may be guessing that this commentary appeared in Forbes or Fortune magazine, or something put out by the Insurance Information Institute. It did not. It actually appeared in the May 3, 1990 issue of Rolling Stone Magazine. This to me dramatically illustrates how broad the coalition for Superfund reform can be. It need not be confined to business men in pinstripe suits. There is no reason why these disparate interests cannot join together to pursue their common goal.

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